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No. 352

In the

# Supreme Court of the United States

October Term, 1924

UNITED STATES FIDELITY & GUARANTY COMPANY,
*Plaintiff in Error,*
*vs.*

A. P. WOOLDRIDGE, RECEIVER NATIONAL BANK OF CLEBURNE, *Defendant in Error.*

**Error to the United States Circuit Court of Appeals for the Fifth Circuit**

## REPLY TO BRIEF OF AMICUS CURIAE

J. H. BARWISE, JR.,
ELLIS DOUTHIT,
THOMPSON, BARWISE & WHARTON,
*Counsel for Defendant in Error.*

FORT WORTH BRIEF PRINTING CO., 1213 THROCKMORTON ST. LAMAR 4070

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## REPLY TO BRIEF OF AMICUS CURIAE

We deem it advisable to make a short reply to the argument filed herein on behalf of the Fidelity & Deposit Company of Maryland as Amicus Curiae. We do this for the reason that that Company does not seem to rely so much upon the same theory as that pressed by Plaintiff in Error in this case, but relies more upon equitable setoff. Under that theory, the apparent contention is that any demand now in the hands of the United States Fidelity & Guaranty Company, Plaintiff in Error, which had its origin prior to insolvency could be used as a setoff in equity,

regardless of equities in others, and regardless of whether or not it arises from the same transaction, and regardless of whether it is mutual within the terms of the principles discussed by various cases directed to the attention of the court in our original reply.

In the first place, we desire to direct attention to the fact that in the quotation made by Amicus Curiae on page 4 from R. C. L., that authority is careful to preserve the contentions we made, in that the principle is recognized that such setoff will be allowed:

> *"Where from the relations and situation of the parties and from the nature of their mutual claims, equity and justice seem to require a complete and speedy settlement."*

In connection with this, it might be well to bear in mind that equitable setoff had its origin from the desire of courts of equity to grant relief where none other existed to avoid multiplicity of suits and to accomplish such results as would be just and fair to all parties concerned, but in doing so, equity has always preserved its principles of equality; regarding that as done which ought to have been done; as not relieving those guilty of bad faith; as requiring those seeking equity to do equity; violating no law and requiring those who seek equity also to come with clean hands.

We have pointed out heretofore that the Surety Company in this case is in the place of the defaulting President of the bank, stands in his shoes, and it

seems to us ought not to have a very high standing in a court of conscience. Undoubtedly, were the funds found in the possession of Norwood, he would be a Trustee *ex maleficio.* If the Surety Company stands in his shoes, why should it be said that it comes with clean hands, and why is it not likewise a Trustee, and why should it not be required to do that which a court of equity would require its principal to do, and not hear him to plead offset against his own misapplication of funds?

It seems to us also that plaintiffs in error confuse their theories somewhat, in that they not only seek subrogation to the rights of the Railway, and through that seek remedies the Railway never had, but also seek through subrogation to have their rights relate back to the inception of the contract when that right does not come through subrogation if it is asserted as an independent offset claimed under equitable principles. We again inquire: Prior to insolvency, what possible right of offset could the Plaintiff in Error have? Obviously none. It therefore seems manifest that Plaintiff in Error is seeking rights as a result of insolvency, which would not exist but for insolvency.

We direct the court's attention to one or two additional authorities pertaining to equitable setoff.

*Ruling Case Law*, Vol. 24, page 871, Section 78, says:

> "Courts of equity will not generally allow a setoff of a joint debt against a separate debt or conversely of a separate debt against a joint debt;

> or to state the proposition more generally, they will not allow a set-off of debts accruing in different rights, but special instances may occur creating an equity which will justify such an interposition."

We direct attention to two cases from this Honorable Court cited as authority to sustain the foregoing statement from Ruling Case Law, which we deem important in view of the contentions made by Amicus Curiae.

The first of those cases is that of *Dade v. Irwin*, 2 How. 383; 11 U. S. (L. Ed.) 308. The court will recall that there is very little difference between the rule for equitable setoff as applied in courts of equity and that enacted into law by the bankruptcy statute. The opinion of the court referred to was written by Justice Story, who, speaking of the rule of setoff, as applied by courts of equity, says:

> "Now it is clear that courts of equity do not act upon the subject of setoff in respect to distinct and unconnected debts, unless some very peculiar equity has intervened calling for relief; as for example, in cases where there has been a mutual credit given by each upon the footing of the debt of the other so that a just presumption arises that the one is understood by the parties to go in liquidation or setoff of the other."

This applies the principle announced by this court in later cases that there should be at least an implied understanding that setoff should exist, and that the circumstances should indicate such an understanding

rather than repel it, as we endeavored to demonstrate in our original reply.

The second case that we desire to direct attention to is the case of *Gray v. Rollo*, 18 Wall. 629, where this Honorable Court was considering a claim of set-off under circumstances which are accurately indicated by a paragraph of the syllabus:

> "A and B were joint makers of certain notes, which were transferred to an insurance company. B and C held policies in this company which became due in consequence of loss by fire. The Company being bankrupt, its assignee claimed the full amount of the notes from A and B. B sought to set off against his half of the liability the claim due to him and C on the policies of insurance, the latter consenting thereto. Held that this was not a case for set-off within the Bankrupt Act, the two obligations having been contracted without any reference to each other."

It seems to us if the two transactions in that instance were separate, distinct and unrelated, with much stronger reason such would be true of the transactions at bar.

Mr. Justice Bradley in delivering the opinion of the court considers the status of the claims as to being mutual debts and mutual credits in language which we think bears on the case at bar.

> "It is clear that these claims are not mutual debts. They are not between the same parties. The notes exhibit a liability of the complainant

and Gaylord; the policies, a claim of the complainant and his brother. But it is said that by the law of Illinois, all joint obligations are made joint and several; and, therefore, that the complainant is separately liable on the notes, and could be sued separately upon them. Granting this to be so, the debts would still not be mutual. If sued alone on the notes, the claim on the policies, which he might seek to set off, pro tanto, against the notes, is a claim due not to him alone, but to him and his brother. His brother's consent that he might use the claim for that purpose would not alter the case. Had his brother's interest been assigned to him before the bankruptcy of the Company, and without any view to the advantage to be gained by the set-off, the case would be different.

"Nor does the case present one of mutual credit. There was no connection between the claims whatever, except the accidental one of the complainant's being concerned in both. The insurance company, so far as apepars, took the notes without any reference to the policies of insurance; and Gray Brothers insured with the Company without any reference to the notes. Neither transaction was entered into in consequence of, or in reliance on, the other; and no agreement was ever made between the parties that the one claim should stand against the other. There being neither mutual debts nor mutual credits, the case does not come within the terms of the Bankrupt law. If it can be maintained at all, it must be upon some general principle of equity, recognized by courts of equity in cases of set-off; which, if it exist, may be considered as applicable under an equitable con-

struction of the act. But we can find no such principle recognized by the courts of equity in England or this country, unless in some exceptional cases which cannot be considered as establishing a general rule. In Pennsylvania, it is true, set-off is allowed in cases where the claims are not mutual, and, in that State, under the decisions there, it is probable that set-off would be allowed in such a case as this."

(It is interesting to note at this point that some of the principal quotations from authorities relied upon by Amicus Curiae are largely based upon the rule in Pennsylvania, which this court declined to follow in the Gray Case.)

"But we do not regard the rule adopted in Pennsylvania as in accord with the general rules of equity which govern cases of set-off. We think the general rule is stated by Justice Story, in his treatise on Equity Jurisprudence, where he says: 'Courts of equity, following the law, will not allow a set-off of a joint debt against a separate debt, or conversely, of a separate debt against a joint debt; or, to state the proposition more generally, they will not allow a set-off of debts accruing in different rights. But special circumstances may occur creating an equity, which will justify even such an interposition. Thus, for example, if a joint creditor fraudulently conducts himself in relation to the separate property of one of the debtors, and misapplies it, so that the latter is drawn in to act differently from what he would if he knew the facts, that will constitute, in a case of bankruptcy, a sufficient equity for a set-off of the

separate debt created by such misapplication against the joint debt. So, if one of the joint debtors is only a surety for the other, he may, in equity, set off the separate debt due to his principal from the creditor; for in such a case the joint debt is nothing more than a securtiy for the separate debt of the principal; and, upon equitable considerations, a creditor who has a joint security for a separate debt, cannot resort to that security without allowing what he has received on the separate account for which the other was a security. Indeed, it may be generally stated, that a joint debt may, in equity, be set off against a separate debt, where there is a clear series of transactions, establishing that there was a joint credit given on account of the separate debt.' Other instances are given by way of illustration of the principle on which a court of equity will deviate from the strict rule of mutuality, allowing a set-off; all of them based on the idea that the justice of the particular case requires it, and that injustice would result from refusing it; but none of them approaching in likeness to the case before the court. There is no rule of justice or equity which requires that Gray Brothers should be paid in preference to other creditors of the insurance company, out of the specific assets represented by the notes of Gray and Gaylord. If the complainant instead of the insurance company were bankrupt, and the notes were valueless, his brother and the creditors of Gray Brothers would think it very hard if the company were allowed to pay the insurance pro tanto with that worthless paper."

It is plainly observed from this that courts of equity do not depart from the strict rule of mutuality except

on the theory that the justice of the *particular* case requires it, and that injustice would result from refusing it. We submit that injustice in the present case would result from granting it, and justice only results from refusing it.

It seems to us that the reasoning of this court pertaining to mutuality is especially forceful and clearly demonstrates that there is none in the case at bar, and that before an offset can be had, the facts must be such as to appeal with peculiar force to a court of equity, and that where there is no mutuality, the courts have not established any principles which offer a fixed guide in determining how far a court of equity will depart from the rule of mutuality in allowing offsets. But apparently each case must have some peculiar equities which appeal to the conscience of the Chancellor as justifying the departing from the rules pertaining to mutuality. We submit that a frank review of all that was done in the present controversy will show that there is no outstanding and appealing equity in favor of plaintiff in error that should give it the right under equitable principles.

We see no sound reason why the insurance company should avoid its solemn obligation to restore stolen funds to their proper sources, simply because, for an adequate consideration, it acted as guarantor or indemnitor on another and independent obligation. If, in the case last mentioned, the brother and the creditors of Gray Brothers would have occasion for hard thought if the setoff in the supposed case was allowed, what may be said of the suffering creditors in this case

if the setoff is allowed here and the insurance company is permitted thereby to discharge obligations of $48,000 by the payment of $25,000, all of which operates, in the name of equity, to pay off and discharge one creditor in full with funds justly belonging to others.

Respectfully submitted,

Eli Dorsett

W. Barnie Jr.

*Attorneys for Defendant in Error.*

Messrs. Seay, Seay, Malone & Lipscomb,
Dallas, Texas,
*Attorneys for Plaintiff in Error.*

Mr. Loren Grinstead,
Seattle, Wash.,

Mr. Frank T. Wyman,
Boise, Idaho,
*Attorneys for Amicus Curiae.*